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SUBJECT: ICELAND: NEW GOVERNMENT PUNTS ON EU QUESTION, PLEDGES A
"NORDIC SOCIAL WELFARE" STATE

Ref: Reykjavik 81

11. (SBU) Summary: Iceland's new leftist government announced its policy statement on May 12, confirming what many expected to be a move towards "traditional" Nordic social and economic policy. Taxes and other revenue streams will need to be increased to meet the government's goal of reduced deficits and a balanced budget by 2013. The Social-Democratic and Left-Green coalition referred perhaps its most pressing issue -- whether or not to apply for EU membership -- to the parliament, in what many here see as a concession to deep LG misgivings. The Prime Minister's Social Democratic party may win the vote on EU talks, but will likely need opposition support to do so. On other foreign policy fronts, the turn towards Nordic cooperation is confirmed, and the U.S. is no longer explicitly noted as Iceland's leading ally in security. As with other budget cuts, the coming battle over defense spending is likely to be bitter. End Summary.

12. (SBU) On May 12, the Social Democratic Alliance (SDA) and the Left-Green Movement (LG) announced the composition and policy statement for their new government formed after the April 25 elections (reftel). It confirms expectations of a sharp left turn in government policy and states that it intends to be a "Nordic welfare government in the truest sense of the word". The new government presented its policy statement as well as a 100-day plan. A resolution authorizing the government to begin EU membership talks will be presented in the upcoming summer session of the Althingi which begins this coming Friday, May 15. SDA figures and political commentators tell Post that the summer session will likely run for six weeks before adjourning for summer holidays and reconvening in late September/early October.

ECONOMY: BALANCED BUDGET, BUT HOW?

13. (U) On the economy, there are not a lot of specifics other than statements about the "tough work ahead" in the 17-page coalition policy agreement. The new government coalition says it wants to ensure economic and social stability, and to seek national unity on Iceland's path to reconstruction through a new "stability pact." PM Sigurdardottir said at the government's first press conference that the government would begin meeting with labor unions and industry leaders to seek broad national consensus on wage cuts and other measures to minimize further job losses. Initial efforts at budget cutting will be announced during the summer, and the government has said initial guidelines on tax hikes and other revenue-boosting measures will be unveiled during the week of May 18. This is in keeping with the government's stated plan to achieve a balanced budget by 2013. The preference (particularly among the Left-Greens) is to raise taxes, with the government implying that it will target the upper end of the socioeconomic spectrum. Press reports from the first government cabinet meeting on May 12 indicate that income

taxes may not be raised immediately, though other taxes on consumers and industry are possible avenues. The new Minister of Fisheries has already floated the idea of an export tax on unprocessed fish, both as a revenue stream and as a way of encouraging domestic job creation in fish processing.

14. (U) Other policy goals (and an effort to hold expectations at a manageable level) are hinted at by sentiments in the policy statement press release: "Guided by the values of equality, social justice, solidarity, sustainable development, gender equality, moral reform and democracy in Iceland, the government aims at creating a Nordic welfare society in Iceland, where collective interests take precedence over particular interests..." "Foremost among its tasks is to revive confidence in the domestic community and rebuild Iceland's international reputation...." The government maintains that if its economic and fiscal plans are successfully implemented, there is a good possibility of acceptable economic growth, low inflation, a stable currency and lower unemployment by the end of its term.

FOREIGN POLICY: LOOKING HOPEFULLY TO THE NORDICS

15. (U) The government's policy statement says little about non-EU foreign affairs, apart from a focus on "collective international security." Defense and security policy -- including the existence and responsibilities of the Icelandic Defense Agency -- will be subject to further review. Defense Agency officials tell us that they have already been told to examine opportunities for cost-saving by combining functions or assets with other government institutions, such as the Coast Guard. Based on comments by Foreign Minister Skarphedinsson earlier this year, this may move rapidly from the exploratory phase into implementation. Also on defense, for the

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first time in decades, the government's stated policy does not mention cooperation with the U.S. as a cornerstone of Iceland's security policy, but instead refers to "allied nations" more generally. The new government states it will strengthen ties with the Palestinian Authority government and will work to promote peace and nuclear disarmament. The government also states its intent to declaring Iceland a nuclear-free zone. (Note: An LG- and SDA-sponsored bill that would have done this did not get out of committee during the spring parliamentary session. End Note.)

EU MEMBERSHIP: DID THE SOCIAL DEMOCRATS PUNT?

16. (SBU) On the EU, the SDA appears to have been pushed back from what initially looked like a very strong negotiating position. Foreign Minister Ossur Skarphedinsson will submit a parliamentary resolution on Iceland's application for EU membership to the Althingi sometime shortly after the new parliament convenes on Friday, May 15. Both parties say their MPs will be free to vote their consciences and not be bound by party strictures on the resolution. PM Sigurdardottir emphasized the need for Iceland to submit the application for membership no later than in July (in part, many believe, to take full advantage of what Iceland hopes will be a charitable view by the Swedish EU Presidency). She said that she is confident that the parliamentary resolution will be approved. Critics of this approach have said that if the resolution is voted down, then it could spell the end of the coalition. Left-Green Chair Sigfusson said his party's MPs will be free to vote their consciences on the resolution. However, five LG MPs have already said they will vote against the resolution. Even if all other LG MPs vote for the resolution -- and some are hinting they may abstain -- the LG "no" votes would mean the SDA will need to recruit some opposition votes in order to reach a majority of 32. Opposition leaders, for their part, have expressed considerable reservation about giving what they say would be a "blank check" to the SDA to handle EU membership talks.

17. (SBU) Several EU Ambassadors in Reykjavik have already noted to post their surprise and concern over the plan to refer the membership question to the Althingi. As one put it, the SDA's need for opposition support raises the question of "how many pounds of

flesh" Sigurdardottir will have to pay out to get the resolution through. Should there be too many concessions to opposition party redlines (e.g., on fisheries, fast-track accession to monetary union, or agriculture), the result could be a membership application that even the Swedes will not be able to support. On the other hand, a defeat would be a devastating loss on the SDA's signature issue from the election campaign and a bad start for the new government.

WHO'S WHO: STABILITY, SURPRISINGLY

18. (U) Prime Minister Johanna Sigurdardottir (SDA Chair) and Finance Minister Steingrímur Sigfússon (Left-Green Chair) retain their current positions, as does Foreign Minister Óssur Skarphedínsson (SDA). Sigfússon and Skarphedínsson have, however, each dropped a ministry, with the LG's Jón Bjarnason picking up the Fisheries and Agriculture portfolio and SDA rising star Katrín Júlíusdóttir heading over to run the Ministry of Industry. Also of note, the two non-political ministers -- the Minister of Justice and the Minister of Economy (formerly known as Business Affairs) -- will stay on. The coalition policy agreement also states plans to re-organize the ministries to have one "Ministry of Employment" to oversee Fisheries, Agriculture, and Industry. This will be implemented in 2010 at the earliest. There is also the potential for a reorganization of other ministries, including the amalgamation of the Ministries of Justice and Communications into a single Ministry of the Interior. PM Sigurdardottir has said she hopes to reduce the total number of ministries to nine by the end of 2010.

The government's 12 cabinet ministers are as follows:

- Prime Minister: Johanna Sigurdardottir (SDA)
- Minister for Foreign Affairs: Óssur Skarphedínsson (SDA)
- Minister of Finance: Steingrímur J. Sigfússon (LG)
- Minister of Health: Ógmundur Jónasson (LG)
- Minister of Justice and Ecclesiastical Affairs: Ragna Arnadóttir (non-party affiliated; MOJ Civil Servant, previously Director of MOJ Office of Legal Policy)
- Minister of Economic Affairs: Gylfi Magnússon (non-party affiliated; Associate Professor in Economics at University of Iceland)
- Minister of Industry: Katrín Júlíusdóttir (SDA)
- Minister of Education, Science and Culture and Minister for Nordic

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Cooperation: Katrín Jakobsdóttir (LG)

- Minister of Social Affairs and Social Security: Arni Páll Arnason (SDA)
- Minister of Communications: Kristján Møller (SDA)
- Minister of Fisheries and Agriculture: Jón Bjarnason (LG)
- Minister for the Environment: Svandís Svavarsdóttir (LG)

19. (SBU) Comment: The biggest surprise from the new coalition agreement is by far the decision to refer EU membership to a parliamentary vote. This is a high-stakes gamble for Sigurdardottir. A win with opposition support gives her a strong hand in leading Iceland towards Brussels and considerable leverage over her Left-Green coalition partners. However, a loss -- and despite the PM's optimistic statements, this is not something we can rule out -- would be a tough blow on the SDA's signature issue from the campaign and would embolden the opposition considerably. Further, as other diplomats here have noted, even a resolution approving the start of talks with the EU may be a poisoned chalice should it be overly loaded with preconditions and caveats.

110. (SBU) Comment, cont'd: On defense and security, one thing is certain -- there will be blood on the floor when the government's new budget comes out. Some here have taken to joking that the Icelandic Defense Agency spends most of its time defending itself from its own government. Depending on how any consolidation with the Coast Guard plays out, this could be proven very true. End Comment.

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